ISA 570 - Going Concern

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Content

- GOING CONCERN ASSESSMENT: REQUIREMENTS OF ISA 570
- GOING CONCERN CONSIDERATIONS; IMPLICATIONS ON THE AUDIT
- COMMON DEFICIENCIES ON GOING CONCERN IDENTIFIED BY GLOBAL REGULATORS
- ROLE OF MANAGEMENT IN GOING CONCERN ASSESSMENTS
- FINAL QUIZ

Going Concern Assessment

REQUIREMENTS OF ISA 570

Requirements of ISA 570

ISA 570 deals with the auditors' responsibilities in the audit of financial statements relating to 'going concern' and the implications for the audit report

Going concern – entity will continue its operations for the 'foreseeable future'. Going concern is a fundamental accounting assumption, based on which financial statements are prepared

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business

Poll # 1: Foreseeable future

Foreseeable future means:

1. 12 months from the Balance sheet date
2. 24 months from the Balance sheet date
3. 12 months from the date on which financial statements are approved by the Board of Directors
4. Foreseeable future is not defined. Assessment is based on auditor judgement and involves at least 12 months from the date of approval of the FS by the Board

Requirements of ISA 570

Responsibilities of the Auditor for assessment of the entity's ability to continue as a going concern:

- Obtain sufficient appropriate audit evidence regarding, and conclude on:
  - appropriateness of management's use of going concern basis of accounting in the preparation of the financial statements,
  - and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.
  - to report, in accordance with the ISA

Requirements of ISAs

Risk Assessment Procedures And Related Activities

- ISAs require auditors to consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern
- Has management already performed preliminary assessment of the entity's ability to continue as a going concern?
- The Auditor is required to remain alert throughout the audit for facts and circumstances which could impact the 'going concern' assumption for preparation of financial statements

Requirements of ISAs

Risk Assessment Procedures And Related Activities

- Events or conditions that may cast significant doubt on entity's ability to continue as a going concern (not exclusive):
  - Financial (net liability/ net current liability position, fixed term borrowing approaching maturity without realistic prospect of renewal or repayment, negative operating cash flows, substantial operating losses/ significant deterioration in value of assets used to generate cash flows etc.)
  - Operating (Management intention to liquidate entity or cease operations, loss of key customers, suppliers refusing to grant credit or reducing credit period)
  - Other (non-compliance with legal and regulatory requirements, adverse key financial ratios, inability to meet loan covenants)

Poll # 2: Board resolution to cease operations

Board has passed a resolution in February 2023 whereby the Company will cease operations on 30 September 2023 due to lack of adequate business. As an auditor, you should insist that:

1. Financial statements of 31 March 2023 are prepared on a ‘realization basis/ liquidation basis’ of accounting and provide an EOM in audit report about this fact
2. Nothing needs to be done since the business is ceasing only after the year-end and it’s a post balance sheet event
3. Request Management to provide a cash flow forecast for the next 12 months
4. Accept preparation of financial statements for 31 March 2023 on a going concern basis

Requirements of ISA 570

Evaluation of Management’s Assessment

- Cover at least 12 months from date of financial statements
- To inquire of management as to its knowledge of events/conditions beyond period of management’s assessment

Requirements of ISA 570

When events/conditions are identified impacting going concern:

- Obtain sufficient appropriate audit evidence to determine whether or not (material uncertainty exists that may case significant doubt on entity's ability to continue as going concern ("MUGC") by performing additional audit procedures, such as:
  - Requesting management to make assessment on ability to continue as going concern
  - Evaluating management's plans for future actions and whether the outcome of the plans are likely to improve situation and whether the plans are feasible
  - Where cash flow forecasts has been prepared:
    - Evaluate reliability of underlying data
    - Determine if there is adequate support for assumptions underlying the forecast
  - Consider any additional facts/ information available since the date of management's assessment
  - Request written management representations

Poll # 3: Significant loan repayments

Company A has long term loans from H Bank of INR 300 crores. Current repayments are INR 80 crores. The cash flow forecast shows operating cash losses. Management is confident that H Bank will provide waiver for repayment, or the Company will raise bridge finance from P Bank to support the loan repayments. Explain your audit approach:

1. Carefully examine communications with H Bank for loan repayment waiver and, if required, meet Bank H officials along with Management to determine whether the waiver will be provided
2. Carefully examine communications with P Bank for bridge finance and examine whether the bridge finance is adequate to cover the loan repayment due
3. Meet the CEO, Board to evaluate going concern and seek Management representations on this matter. Consider para of Material uncertainty of going concern in the auditors' report
4. All of the above

Auditors' conclusion

- Evaluate based on audit evidence, whether MUGC exists, and may cast significant doubt on the entity's ability to continue as a going concern
  - Material uncertainty exists when magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for the fair presentation of the financial statements

If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine:

(a) whether the financial statements adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

(b) whether the financial statements disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business

Poll # 4: Cancellation of telecom licenses

Company T has telecom licenses in 4 circles which were cancelled due to Supreme Court order on 30 June 2011. Company T is a 50%-50% JV of IT and FT.

IT intends to challenge the SC order. FT is planning to exit the JV. Company T has investments in capex of Rs 1,000 crores. No other assets other than PPE. What is your view as an auditor of FS for year ended 31 March 2021:

1. Since IT is challenging the SC order and the matter is sub-judice, it supports preparation of financial statements on a going concern basis
2. The SC order is a post balance sheet event and adjustments will be incorporated in the financial statements for 31 March 2012
3. Since FT is keen to exit, it creates a material uncertainty of going concern and hence a para on MUGC should be inserted in the auditors' report
4. There are significant multiple uncertainties and since PPE is material and pervasive to the financial statements, the auditor may need to consider a disclaimer opinion on the financial statements

Going Concern considerations

IMPLICATIONS ON THE AUDIT

Implications on the Audit

Basis on which FS is prepared by Management	Auditors’ assessment of going concern	Type of audit Opinion
Going concern basis	Appropriate	Clean opinion, if there is no material uncertainty of going concern
Going concern basis	Inappropriate	Adverse opinion, since the impact of an inappropriate preparation will be material and pervasive to the financial statements

Implications on the Audit

Basis on which FS is prepared by Management	Auditors’ assessment of going concern	Material uncertainly of going concern exists?	Adequate disclosures in the financial statements?	Audit Opinion
Going concern basis	Appropriate	Yes	Yes	Emphasis of matter on ‘material uncertainty of going concern’
Going concern basis	Appropriate	Yes	No	Qualified for inadequate disclosures/ Adverse opinion depending on materiality and pervasiveness

Implications on the Audit

Clean opinion with an emphasis of matter on MUGC:

Material Uncertainty Related to Going Concern

We draw attention to Note 6 in the financial statements, which indicates that the Company incurred **a net loss of ZZZ** during the year ended December 31, 20X1 and, as of that date, the Company's **current liabilities exceeded its total assets by YYY**. As stated in **Note 6**, these events or conditions, along with other matters as set forth in Note 6, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is **not modified** in respect of this matter."

Implications on the Audit

Qualified opinion due to inadequate disclosures in the notes to financial statements. Impact is material but not pervasive:

Basis for Qualified Opinion

As discussed in Note yy, the Company's **financing arrangements expire and amounts outstanding are payable on March 19, 20X2**. The Company has been **unable to conclude re-negotiations or obtain replacement financing.** This situation indicates that **a material uncertainty exists** that may cast significant doubt on the Company's ability to continue as a going concern. The **financial statements do not adequately disclose** this matter……. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Implications on the Audit

Adverse opinion due to non-disclosure in the notes to financial statements and the impact is both material and pervasive:

Basis for Adverse Opinion

The Company's **financing arrangements have expired, and the amount outstanding was payable** on December 31, 20X1. The Company has not been **able to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy**. This situation indicates that a **material uncertainty** exists that may cast significant doubt on the Company's ability to continue as a going concern. The **financial statements do not adequately disclose this fact**………We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

Going Concern Assessments

COMMON DEFICIENCIES ON GOING CONCERN IDENTIFIED BY GLOBAL REGULATORS

COMMON DEFICIENCIES ON GOING CONCERN – NFRA

*In the Annual Report for **FY 22**, whilst reporting on **AQRRs** completed, NFRA has criticized the audit firm, XYZ LLP in carrying out the audit of Jaiprakash Associates Limited for the financial year 2017-2018 as follows:*

“the audit firm had failed to appropriately and sufficiently evaluate the use of going concern basis of accounting by the management and had thus failed to note the implications thereof in the auditors’ report”

In the same report, NFRA has criticized the audit firm, ABC LLP for in carrying out the audit of ILFS Transportation Networks Limited (ITNL) for the financial year 2017-2018 as follows:

“the audit firm had failed to appropriately and sufficiently evaluate the use of going concern basis of accounting by the management and had thus failed to note the implications thereof in the auditors’ report”

COMMON DEFICIENCIES ON GOING CONCERN – CPAB

"Auditors can do more to proactively assess going concern risk and apply professional skepticism consistently. It is imperative that auditors identify early warning indicators, challenge management and assess the quality of management's disclosures.

More robust and detailed guidance would improve consistency between auditors and management on how to approach the assessment and disclosure of going concern uncertainties and particularly in close call situations."

Canadian Public Accountability Board (CPAB)

Poll # 5: 'Close call'?

What is the meaning of a 'close call' as per the regulators?

1. Management asserts that going concern is appropriate; and the auditor is also satisfied with the appropriateness of use of going concern
2. Management asserts that going concern is appropriate; however, the auditor is not satisfied with the documentation
3. Management asserts that going concern is appropriate; the auditor agrees, however there still some uncertainties. The auditor hasn't elevated these uncertainties as material uncertainties
4. Management has got into closed door meetings with the bankers and the auditors. The auditors are now satisfied that going concern is appropriate

COMMON DEFICIENCIES ON GOING CONCERN – CPAB

Category		Description	# of files
I	Close calls — events or conditions and no material uncertainty	Events or conditions were identified that may cast significant doubt on the reporting issuer's ability to continue as a going concern, but the auditor concluded that they did not rise to the level of material uncertainty. The auditor is required to evaluate whether the disclosures in the financial statements provide adequate disclosures about the events or conditions as required by the applicable financial reporting framework (a close call scenario).	7
II	Going concern disclosures	Events or conditions were identified that may cast significant doubt on the reporting issuer's ability to continue as a going concern and the auditor concluded that material uncertainty exists. Management disclosed material uncertainties related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern, and the auditor's opinion included an emphasis of matter related to going concern.	28
	Total		35

COMMON DEFICIENCIES ON GOING CONCERN – FRC

“While the Board of the relevant entity is responsible for the going concern assessment, auditors are required to audit it in accordance with ISA (UK) 570 Going Concern, and firms need to ensure there are appropriate policies and procedures in place for this.”

Financial Reporting Council (FRC)

COMMON DEFICIENCIES ON GOING CONCERN- FRC

3) Reverse stress and scenario testing assisted in the assessment of whether there was a material uncertainty

On two audits there was insufficient consideration as to whether the actions identified by management of the audited entity were achievable or sufficient to mitigate the impact of the stress testing. On one of these audits, the actions included the raising of new funds, which were also intended to complete an acquisition, however the updated cashflow forecasts did not factor in the cost of the acquisition.

Poll # 6: Financial support letter

We are auditing Company GHI for the financial year ended 31 March 2022. The Company has a net current liability of INR 20 million. A promoter director is providing a financial support letter to the Company. Which of the following audit procedures would you perform?:

1. Include the financial support by director in the Management Representation Letter
2. Have the promoter director sign the financial support letter and assess the ability of the promoter director to provide financial support
3. Ensure that the material uncertainty of going concern and existence of a financial support letter from the promoter director is adequately disclosed and insert an emphasis of matter
4. Both (2) and (3) above

COMMON DEFICIENCIES ON GOING CONCERN- ACRA

*"Whilst management is responsible for the evaluation of the companies' ability to continue as a going concern under FRS 1 Presentation of Financial Statements, public accountants should also be cautious and exercise professional scepticism when evaluating the **quality of audit evidence obtained** in support of management's assessment, including the **adequacy of disclosures made** by management and the need to extend the going concern assessment beyond twelve months from the date of the financial statements*

Accounting and Corporate Regulatory Authority (ACRA)

COMMON DEFICIENCIES ON GOING CONCERN- ACRA

Common Findings on Going Concern Assessment	Key Reminders
Evaluation of the appropriateness of management's going concern assumptions ACRA noted that public accountants had accepted management's representations without obtaining sufficient appropriate audit evidence to corroborate management's representations. For example, • sources of financial support and the financial ability of the other party to provide the support; or • the outcome of a future event (e.g. refinancing of loans, success of new business model pivoted during the pandemic or new product launches).	For financial support provided by another party (e.g. holding company), public accountants should not only evaluate the **financial ability**, but also the **intent** of the other party to continue to provide the said financial support to the entity. For unutilised credit facilities, public accountants should evaluate whether there would be continued support from the bank or lender throughout the period of assessment, including the ability of the entity to comply with the financial covenants, if any. For auditor's reports with "*Material Uncertainty Related to Going Concern*", public accountants are still required to assess and conclude that management's use of going concern basis of accounting remain appropriate to support the unmodified audit opinion.

Role of Management in ‘going concern’ assessments

Role of Management

Management has an important role to play in the going concern assessment:

- Primary responsibility for assessment of going concern on Management as per IAS 1
- Management should prepare a forecast balance sheet, profit and loss and cash flow statement for a period of at least 12 months or longer if the circumstances demand
- Management should set out clearly the assumptions used in preparing the forecast financial statements and cash flows
- Management should data obtained from independent sources to determine revenue growth rate, expected gross margins and working capital lock-in
- Management should engage experts in case of preparation of multiple scenarios involving multiple uncertainties
- Provide access to bankers, CEO, Board to the auditor to enable them to conclude on ‘going concern’ as a basis for preparation of the financial statements
- Get the forecast/ projected financial statements approved by the Board
- Ensure that adequate disclosures are made in the financial statements involving material uncertainties of going concern
- Provide written management representations to the auditors as deemed necessary

Requirements of ISA 570

- Assessment of ‘going concern’ is a Management judgment
  - at a particular point in time
  - about inherently uncertain future outcomes of events or conditions
  - judgment about the future based on information available at the time at which judgment is made

Poll # 7: Final Quiz

You are auditing a company which runs a hotel in Nigeria. Due to political and economic unrest, its occupancy is down to 2% and is not expected to improve. Management has provided a financial support letter from the Parent company to enable preparation of financial statements on a going concern basis. Choose the correct answer:

1. It’s a close call situation however there is no material uncertainty and hence we can issue a clean audit opinion
2. There is no material uncertainty and financial statements can be prepared on a going concern basis
3. There is a material uncertainty of going concern requiring adequate disclosures in the notes and an emphasis of matter paragraph in the audit report

Poll # 8: Final Quiz

You are auditing a company S which is into losses. The Parent Company P has provided a conditional support letter which states that the financial support will be provided only till the time S continues to be a subsidiary of P and case of disposal, the financial support letter stands withdrawn. Choose the correct answer:

1. It's a close call situation since the support letter is conditional. However, there is no material uncertainty and hence we can issue a clean audit opinion
2. We will need to engage with P's Management to determine if there is a disposal situation (sale of subsidiary) within the next 12 months. If no sale is expected, then the support letter is fine.
3. A conditional support letter will not work. We don't have sufficient appropriate audit evidence to conclude on going concern for entity S. This will impact our audit report.
4. Ascertain if there is a disposal event. If 'no', then determine if the Parent P has the ability to support going concern. Then determine whether a MUGC still exists and its impact on the audit report.

Poll # 9: Final Quiz

You are auditing a start up company EXR which is incurring losses since its into on-line fashion retail. Management has prepared a cash flow forecast for the next 24 months whereby the company will run out of cash reserves by 31 March 2025. You are auditing 31 March 2023 and are satisfied with the cash flow projections and forecasts:

1. Nothing to be done. The Company will get more cash through its existing or new investors and hence there is no going concern issue
2. Our evaluation is only required for 12 months so running out of cash in 24 months is a non-issue for the audit report
3. Since the cash will be over in 24 months, we should require Management to do appropriate disclosures in the financial statements. A MUGC may or may not be required
4. We should refer to financial statements of other start up companies in the same sector to check if they faced going concern issues

Poll # 10: Final Quiz

You are auditing a Holding company PB Limited, which is a shell company and has a single operating subsidiary MR Limited. The auditor of the subsidiary MR has given a material uncertainty of going concern para in the audit report. You need to evaluate the impact of this MUGC on the consolidated audit opinion:

1. Since the single subsidiary has a MUGC, the consolidated audit report will replicate the MUGC
2. Determine through discussions with the auditor of MR why there is a MUGC and then determine based on group materiality if this leads to a MUGC on the consolidated financial statements
3. Ignore the MUGC of the subsidiary auditor and draw your own conclusions in this matter.
4. Give a disclaimer opinion on the PB consolidated financial statements since the operating subsidiary has an EOM on material uncertainty of going concern

Questions?

Thank You